***Laureys v. Commissioner, 92 T. C. 101; 1989 U. S. Tax Ct. LEXIS 6; 92 T. C. No. 8 (1989)***

Offsetting positions in options do not constitute a “similar arrangement” under section 465(b)(4), and losses from options trading by a market maker must be treated as capital losses if not conducted as dealer activity.

**Summary**

Frank J. Laureys, a Chicago Board of Options Exchange (CBOE) market maker, engaged in various option spread transactions and reported significant losses on his tax returns. The IRS challenged these losses, arguing they were not deductible under the at-risk rules of section 465(b)(4) and should be treated as capital losses rather than ordinary losses. The Tax Court held that offsetting positions in options do not constitute a “similar arrangement” under section 465(b)(4), allowing the losses to be recognized for tax purposes. However, the court ruled that these losses must be treated as capital losses because the transactions were not conducted in Laureys’ capacity as a dealer but for his own account.

**Facts**

Frank J. Laureys, Jr. , was a full-time CBOE market maker trading exclusively for his own account from June 1980 through January 1983. During 1980 to 1982, he engaged in numerous option spread transactions, including butterfly spreads and time spreads, primarily in Teledyne, Inc. (TDY) options. Laureys reported substantial losses from these transactions in 1980 and 1982, offset by gains in subsequent years. The IRS challenged these losses, asserting that they were not deductible under section 465(b)(4) and should be treated as capital losses rather than ordinary losses.

**Procedural History**

The IRS issued a statutory notice of deficiency to Laureys, disallowing the claimed losses from the option transactions for the tax years 1980, 1981, and 1982. Laureys petitioned the U. S. Tax Court for redetermination of the deficiencies. The IRS later conceded that the transactions were not shams but maintained that the losses were limited by section 465 and should be treated as capital losses. The Tax Court heard the case and issued its opinion on January 25, 1989.

**Issue(s)**

1. Whether offsetting positions in options constitute a “similar arrangement” under section 465(b)(4), limiting the deductibility of losses?
2. Whether Laureys’ option spread transactions were entered into primarily for profit and had sufficient economic substance to be recognized for tax purposes?
3. Whether the losses from Laureys’ option transactions should be treated as ordinary losses or capital losses?

 

## Holding

1. No, because the term “similar arrangement” in section 465(b)(4) does not include well-recognized options straddles, and Laureys was at risk for the full amount of his investment.
2. Yes, because Laureys’ primary purpose in engaging in the transactions was consistent with his overall portfolio strategy to make a profit, and the transactions had sufficient economic substance.
3. No, because the transactions were not conducted in Laureys’ capacity as a dealer but for his own account, thus the losses must be treated as capital losses.

## Court’s Reasoning

The Tax Court reasoned that section 465(b)(4) was not intended to address the well-known issue of options straddles, which are specifically addressed in other sections of the tax code. The court rejected the IRS’s argument that offsetting positions in options constituted a “similar arrangement” under section 465(b)(4), as this would require a departure from the annual accounting method and the creation of a new rule for options straddles. The court found that Laureys’ transactions were entered into with a profit motive and were part of his overall trading strategy, thus having sufficient economic substance to be recognized for tax purposes. However, the court determined that the transactions were not dealer activities because they were not conducted to meet the demands of the market or to create liquidity but were for Laureys’ personal account. Therefore, the losses from these transactions were to be treated as capital losses rather than ordinary losses.

## Practical Implications

This decision clarifies that offsetting positions in options do not fall under the at-risk rules of section 465(b)(4), allowing taxpayers to deduct losses from such transactions if they have a profit motive. However, it also emphasizes that losses from options trading by a market maker must be treated as capital losses unless the transactions are conducted in the capacity of a dealer. This ruling may affect how market makers structure their trading activities and report their income for tax purposes. It also highlights the importance of distinguishing between dealer and non-dealer activities in options trading. Subsequent cases have built upon this ruling, further refining the treatment of options transactions under the tax code.